No. 15,025

In the United States Court of Appeals for the Ninth Circuit

HAROLD WENER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

MOLLY WENER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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In the United States Court of Appeals for the Ninth Circuit

No. 15025

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COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

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ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The Tax Court's findings of fact and opinion (R. 40-47) are reported at 24 T.C. 529.

JURISDICTION

These petitions for review (R. 49-53) involve federal income taxes for the taxable year 1947. On December

21, 1951, the Commissioner mailed to the taxpayer Harold Wener notice of a deficiency in the total amount of $5,279.53 (R. 7-11), and to the taxpayer Molly Wener notice of a deficiency in the total amount of $238.59 (R. 17-20). Within ninety days thereafter and on March 19, 1952, the taxpayers filed petitions with the Tax Court for redeterminations of these deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939 (R. 3-11, 12-20.) The decisions of the Tax Court were entered on September 2, 1955. (R. 48-49.) These cases were brought to this Court by petitions for review filed December 2, 1955. (R. 49-53.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court correctly upheld the Commissioner's determination that the taxpayers sustained capital losses within the meaning of Sections 23(g) and 117 of the Internal Revenue Code of 1939 where they sold capital assets, partnership interests, for a stated amount to be paid in installments, and later in the same taxable year, because they needed cash, reduced through renegotiation the original purchase price and accepted in complete satisfaction an immediate cash payment in an amount which was less than the aggregate of the remaining installment payments due.

2. If the Tax Court erred in holding that the taxpayers sustained capital losses, whether the taxpayers have shown that their losses were deductible as ordinary losses "incurred in trade or business" within the meaning of Section 23(e) of the 1939 Code.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

*   *   *   *   *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

*   *   *   *   *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

*   *   *   *   *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [as amended by Sec. 115(b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or bus-

iness), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1); or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

* * * * *

(d) *Limitation on Capital Losses.*—

* * * * *

(2) [as amended by Sec. 150(c) of the Revenue Act of 1942, *supra,* and Sec. 8(d)(2) of the Individual Income Tax of 1944, c. 210, 58 Stat. 231] *Other taxpayers.*—In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of [*sic*] $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed under Supplement T, "net income" as

used in this paragraph shall be read as "adjusted gross income".

(26 U.S.C. 1952 ed., Sec. 117.)

STATEMENT

The facts as stipulated and found by the Tax Court may be summarized as follows:

The taxpayers, husband and wife, were members of a partnership doing business in Illinois and Wisconsin, as the Boreva Sportswear Company. (R. 41.) After differences arose between the taxpayers and the other partners, on September 6, 1946, a Dissolution Agreement was executed wherein it was agreed that the taxpayers would retire from the partnership as of January 31, 1947, the remaining partners to purchase their interests. The Dissolution Agreement provided generally that the sums to be paid for the taxpayers' interests by the remaining partners were to be measured by the book values of their interests as of the severance date plus a specified sum. (R. 42.) The agreement also provided that payments to the taxpayers for their partnership interests were to be made on an installment basis: An initial payment on or before thirty days from January 31, 1947, one on or before January 31, 1948, another on or before April 15, 1948, and the final payment on or before April 15, 1950. Interest was to run on all payments except the first. (R. 42-43.)

The taxpayers' interests in Boreva were conveyed under a bill of sale dated February 1, 1947, as of the close of business on the preceding day. (R. 43.)

After the initial payments were made, there was a balance of $38,713.86 due the husband and $19,564.27

due the wife to be paid in the three remaining installments. (R. 43-44.)

Subsequent to their agreement to withdraw from Boreva, the taxpayers moved to California where they established a business. (R. 44.)

Also in 1947, on August 25, before any further payments were due from the sale of their interests in Boreva, the taxpayers, in consideration of an immediate cash payment, accepted and received $35,000 in complete satisfaction of the aggregate amounts which would have become payable to them on the various installment dates. The husband's share of this sum was $23,257.50 and that of the wife was $11,742.50. (R. 44.)

One factor which prompted the taxpayers to initiate the negotiations which resulted in the adjustment of the terms of the original sales agreement was their present pressing need of funds for use in their new California business. (R. 44.)

Under the agreement for immediate payment the husband received $15,456.36 less and the wife $7,803.77 less than would have been due them had the original terms of the agreement been followed. In their returns for 1947 the taxpayers treated these amounts as ordinary losses, deductible in full. (R. 44-45.)

The Commissioner, however, determined that the losses were capital losses under the statute and subject to the limitations provided therein. (R. 45.)

The Tax Court sustained the Commissioner's determination of deficiencies (R. 48-49), holding that the losses were sustained by the taxpayers from the sale of their capital interests in the partnership (R. 46). From that decision the taxpayers here appeal. (R. 49, 51.)

SUMMARY OF ARGUMENT

There is no dispute that in February, 1947, when the taxpayers formally conveyed their interests in Boreva Sportswear to their old partners, a capital loss was sustained. The principal question for consideration in this case is whether the additional loss which the taxpayers suffered when they renegotiated their February agreement in order that they might receive an immediate cash payment rather than wait for installment payments was a capital loss.

The additional loss sustained as a result of the August transaction resulted simply from an adjustment in the terms of the original agreement of February and the later transaction must be viewed as one step in the total sale by the taxpayers of capital assets, their partnership interests. Well within the same year that the conveyance of the partnership interests was made, and in which the initial payment was received, the taxpayers decided to renegotiate the installment payment provisions which were the unexecuted portions of the sales contract, and to accept a present cash payment in lieu of later installment payments. The effect of this action was to supersede the provisions of the contract which had originally prescribed the terms, dates and amounts of payments by renegotiated provisions providing for prompt payment. Since admittedly the acts of the taxpayers in February resulted in the sale or exchange of a capital asset, a modification of the February transaction later in the same year must of necessity partake of the same nature as the February transaction.

There are ample decisions that support the Commissioner's contention that where a single transaction such

as this takes place in a sequence of events, in order to determine the nature of the final step one must first consider the original steps of the transaction. Another long line of cases hold under certain circumstances that a cancellation or compromise of indebtedness simply resulted in a "readjustment of the purchase price" of the property for which the debt was incurred.

The Tax Court held that the February and August transactions were completely interwoven when it stated that the effect of the later transaction was to supersede the earlier. There is not present in this case the ordinary situation of a satisfaction of an indebtedness for a lesser amount, but rather a case which clearly presents, under the facts as found by the Tax Court, an instance of a complete adjustment in the terms of the original executory contract of sale of a capital asset.

If the Court should hold that the loss is not a capital loss, then it is necessary for the taxpayers to show that they fall within some specific provision of the Internal Revenue Code allowing a deduction for such loss as an ordinary loss. This they have failed to do.

The cases cited to the effect that a compromise or cancellation of indebtedness result in income to the debtor have no bearing on whether or not the same compromise or cancellation of indebtedness results in a deductible loss to the creditor since what may be income reportable by a debtor is not necessarily a loss *deductible* by the creditor. It is well established that deductions from gross income are a matter of legislative grace. There is, moreover, no basis to taxpayers' contention that the loss in question was incurred in a trade or business and that it is therefore deductible under Section 23(e)(1) of the Code.

Adopting, for the purposes of argument, the view of taxpayers that the August transaction must be considered separate and apart from anything that occurred earlier, it is difficult to see how they attach the loss to a trade or business. The claim which was held was completely unrelated to any business which the taxpayers happened to be in at the time that the loss was incurred. And the mere fact that they happened to be in financial difficulties in a new and unrelated business which was established subsequent to the sale of the partnership interests does not serve to relate this particular claim to the new business which was formed after the claim arose. The fact that the taxpayers needed capital for their new business does not make the loss in August a loss of the new business. In order to be deductible under Section 23(e)(1) of the Code a loss must be the proximate result of the business enterprise. From the agreed facts it can be seen here that this loss did not arise out of the California enterprise but was a result of a series of transactions concerning the sale of interests in a separate and distinct partnership which operated in a different locality. Furthermore, the sale of these partnership interests did not constitute a trade or business of taxpayers. What the taxpayers desired to do with the proceeds of the sale is not material herein, and the mere fact that they used the proceeds as capital in their new and unsteady enterprise is of no consequence.

Since the loss in question was not a loss incurred in trade or business, the taxpayers are not entitled to deduct any portion of the loss unless the Commissioner's position that this was a loss in the sale of a capital asset

is upheld, and then only the portion provided by the statute.

It is therefore submitted that the decision of the Tax Court was correct and should be affirmed.

ARGUMENT

I

The Taxpayers Sustained a Capital Loss Where They Renegotiated an Executory Agreement to Sell Partnership Interests and Accepted in Consideration of an Immediate Cash Payment an Amount Which Was Less than the Total Remaining Installment Payments

There is no dispute that in February, 1947, when the taxpayers formally conveyed their interests in Boreva Sportswear to their old partners, a small capital loss was sustained. (Br. 6, 19.) The principal question for consideration in this case is whether the additional loss which the taxpayers suffered when they renegotiated their February agreement in order that they might receive an immediate cash payment rather than wait for installment payments was a capital loss within the meaning of Sections 23(g) and 117 of the Internal Revenue Code of 1939. If, as the taxpayers contend, this was not a capital loss, then, as we discuss under Point II, *infra,* it is incumbent upon them to prove that it was an ordinary loss "incurred in trade or business" within the meaning of Section 23(e)(1) of the 1939 Code before they are entitled to deduct it.

A. *The transaction in August, 1947, was an adjustment of the purchase price and payment dates of the executory contract of sale dated February, 1947, and its nature is determined by relating back to the February portion of the transaction*

It is the position of the Commissioner that the additional losses of $15,456.36 and $7,803.77 sustained by

the taxpayers, Harold and Molly Wener, respectively (R. 45), as a result of their transaction in August, 1947, resulted simply from an adjustment in the terms of the original agreement of February, 1947, and that the August transaction must be viewed as one step in the total transaction, *viz.,* the sale by taxpayers of capital assets, their partnership interests. The taxpayers contend that the August transaction must be considered in a vacuum, with no reference at all to the part of the transaction which took place in February. They agree that for at least the February part of the transaction they suffered a capital loss. (Br. 6, 19.) That there is neither rhyme nor reason for viewing two such related transactions as entirely independent transactions may be seen by considering the situation as it stood immediately prior to the readjustment effected in August, 1947. As of that date the taxpayers, Harold and Molly Wener, had received only initial payments for their interests in the partnership in the amounts of $10,428.28 and $5,265.13, respectively. (R. 43.) The contract of sale of these interests was still unexecuted as far as concerned payment of the balance of the purchase price, namely, $38,713.86 and $19,546.27, due Harold and Molly Wener, respectively, in installments over three years. (R. 42-44.) Well within the same taxable year that the conveyance of the partnership interests was made, and in the same year in which the initial payments for such interests were received, the taxpayers decided to and did renegotiate and revise the unexecuted portions of the sales contract, the installment payment provisions, and thereby accepted present cash payments of $23,257.50 and $11,742.50, respectively (R. 44), in

lieu of later installment payments.[1] The effect of this action was to supersede the provisions of the contract which had originally prescribed the terms, dates and amounts of payments by renegotiated provisions providing for prompt payment. Since admittedly the acts of the taxpayers in February resulted in the sale or exchange of a capital asset, a modification of the February transaction later in the same year must of necessity partake of the same nature as the February transaction. If what happened in February resulted in a capital loss, then the modification of the February agreement in August and the concomitant complete adjustment in the terms thereof must likewise result in capital loss. The nature of the loss which resulted in August can be determined only by reference to the original transaction which took place in February.

While there do not appear to be any decided cases completely in point to that presently at the bar, there are ample decisions that tend to support the Commissioner's contention that where a transaction such as this takes place in a sequence of steps, to determine the nature of the final step, one must first consider the original step of the transaction. In this respect, the decision of the Supreme Court in *Arrowsmith* v. *Commissioner,* 344 U.S. 6, is a strong buttress to the Commissioner's position. The *Arrowsmith* case involved various steps in the liquidation of a corporation. In 1940 the corporation made its final distribution in liquidation and the taxpayer distributees reported capital gains thereon. The liquidation was

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[1] The taxpayer agrees (Br. 5-6) that the obligation under the contract was not represented by a note or other evidence of indebtedness, and was merely an unsecured contractual obligation to pay a certain sum of money in installments over a period of time.

considered a closed transaction at this time. In 1944 a judgment was rendered against the liquidated corporation for which the taxpayers were liable since they were transferees of the assets of the corporation. The taxpayers paid this judgment and each classified the loss as an ordinary business loss for which they took a full deduction. The Commissioner, taking the position that the nature of the transaction related back to the original liquidation, held that the 1944 payment was a part of the original liquidation transaction which was a capital transaction and thus required classification as a capital loss just as the taxpayers had treated the original dividends in liquidation as capital gains. The Supreme Court affirmed the Commissioner's determination and held that the loss sustained was a capital loss. In reaching this decision the Court first determined that the taxpayers were required to pay the judgment because of the liability imposed on them as transferees of the liquidation distribution assets, and that this payment was one of the steps in the liquidation of the corporation. The Court then stated that it was necessary to consider each of the various events in the liquidation process in order to classify properly the nature of the 1944 loss for tax purposes. Since the liquidation as a whole resulted in capital gain, then this individual payment resulted in capital loss rather than an ordinary loss. In addition, it was pointed out that if the payment in question had been made in 1940, the year of the final distribution in liquidation, then its effect would simply have been to reduce the amount of capital gains which the taxpayers received during that year. Correspondingly, if the taxpayers in the instant case had decided in February

of 1947, at the time they conveyed their interests, that they were going to desire an immediate cash payment for their partnership interests rather than abide by the installment payment provisions originally contemplated, it cannot be disputed that the entire loss would have been a capital loss. In this case the Tax Court found (R. 46-47) that the August transaction was part and parcel of the original capital transaction which took place in February of the same year. Thus the rationale of the holding in the *Arrowsmith* case that the 1944 loss was a part of the original liquidation process is clearly applicable. The holding in *Arrowsmith* becomes even more potent in support of the Commissioner's position in this case when it is considered that in *Arrowsmith* the taxpayers argued strenuously, supported by previous decisions (see, e.g., *Commissioner* v. *Switlick,* 184 F. 2d 299 (C.A. 3d)), that to classify the 1944 loss as part of the liquidation process of earlier years would be to fly in the teeth of the annual accounting concept. The holding that the annual accounting concept was not breached by considering the nature of the transaction which took place in the earlier year in order to classify the later transaction carries the necessary implication that in a sequence of events, *all occurring within a single year,* a loss resulting from a modification of an executory contract previously entered into will *a fortiori* be classified as capital or ordinary by relating back to the nature of the original transaction. If there may be a relating back to an earlier year to determine the nature of a transaction there surely is more reason for allowing a relating back to a transaction in the *same* taxable year.

Another illustration of the propriety of relating back to the original transaction in order to determine the nature of a subsequent part of such transaction is set forth in *Sanders* v. *Commissioner,* 225 F. 2d 629 (C.A. 10th), certiorari denied, 350 U.S. 967, where the taxpayer compromised an unliquidated claim under a construction contract against the Government. As against the taxpayer's argument that the sum received in compromise was a capital gain, it was held instead to be ordinary income. The court, in deciding that a sale or exchange of a capital asset had not taken place, reached this decision by considering the income in the light of the claim from which it was realized. Since the original claim was for services performed, and if the claimed sums had been paid when due ordinary income would have been received, the court in relating the settlement back to the original transaction, held that the transaction was not a sale or exchange of a capital asset but rather was the receipt of ordinary income.

Still another line of cases view a later transaction in the light of an original transaction. These are the "readjustment of purchase price" cases and it is submitted that their reasoning is pertinent to the present case. In *Hirsch* v. *Commissioner,* 115 F. 2d 656 (C.A. 7th), the taxpayer purchased in 1928 certain real estate, paying for it with cash and by the assumption of a mortgage debt on the property. By 1936 the property had depreciated in value to an amount less than the sum of the remaining mortgage payments. The mortgagee voluntarily reduced the amount of the mortgage indebtedness to the then value of the property. While the Commissioner contended that the reduction of the

mortgage indebtedness resulted in income to the taxpayer, the court refused to follow this reasoning and held that based on the particular circumstances of the case it could be seen that this transaction was in its essence a reduction of the original purchase price and therefore not income. It can be seen that the court refused to view as separate and apart the transactions of each year, and took all of the circumstances of the case into consideration. To like effect were the decisions in *Helvering* v. *A. L. Killian Co.,* 128 F. 2d 433 (C.A. 8th); *Gehring Publishing Co.* v. *Commissioner,* 1 T.C. 345; and *Pinkney Packing Co.* v. *Commissioner,* 42 B.T.A. 823. All of these decisions stand for the proposition that the transaction must be viewed in its entirety when the particular circumstances so warrant, and that a sale of property and the debt which arises from the sale of property may not in every instance be considered completely divorced from each other for tax purposes. And so in the present case it is submitted that the facts offer no warrant for the position of the taxpayer that the sale of the partnership interests and the remaining installment payments due on these interests under the executory contract of sale must be severed in considering the nature of the loss arising from each transaction. Indeed, the Tax Court held that the February and August transactions were completely interwoven when it stated in its opinion (R. 46):

> After the initial payments, but later in the same year and before any of the installments had become due and payable, the petitioners, for reasons which were solely their own, saw fit to renegotiate the unexecuted portions of the sales agreement,

> namely, the deferred payment provisions, to the end that for a present cash payment in lieu of later payments in installments, as theretofore provided, the petitioners agreed upon and accepted reduced prices for their interests in Boreva. These renegotiated provisions superseded the provisions which had originally prescribed the terms, dates and amounts of payment, and the transaction was closed pursuant thereto.

And the taxpayer concedes (Br. 4) that the findings of the Tax Court accurately set forth the facts involved.

Faced with the problem of determining the correct basis upon which to figure depreciation in the taxpayer's plant, the Sixth Circuit in *Borin Corp.* v. *Commissioner,* 117 F. 2d 917, considered a problem analogous to that presently before the Court. In *Borin* the taxpayer in 1930 contracted with another company whereby the latter was to install machinery in the taxpayer's plant. Because of the unsatisfactory operation of this machinery, the taxpayer refused to make certain payments under the contract. After negotiations a substantial sum was allowed the taxpayer by way of adjustment, the renegotiation being handled by the execution of a new contract in 1932 between the parties. The taxpayer contended that the basis of his plant was the cost as represented by the first contract in 1930 and that the adjustment amount was by way of damages. The court, however, held that the effect of the 1932 contract was to rescind the 1930 contract and that the basis for depreciation was properly represented by the cost as set forth in the 1932 contract. See also *Des Moines Improvement Co.* v. *Commissioner,* 7 B.T.A. 279;

Chenango Textile Corp. v. *Commissioner,* 1 T.C. 147. It can be seen from the cited cases that the courts have refused to sever under legal fiction various steps in a single transaction which the circumstances show to be only parts of the overall transaction.

The theory of the taxpayer herein is that the August transaction was a cancellation of indebtedness resulting in an ordinary loss to the taxpayers. (Br. 7.) Yet there is no reason why the mere fact that a creditor-debtor relationship arising out of the executory contract existed between the taxpayers and their former partners at the time of the August renegotiation of the contract of sale should change the basic nature of the transaction. There is not present here the ordinary case of a satisfaction of an indebtedness for a lesser amount, but rather a case which clearly presents, under the facts as found by the Tax Court, an instance of a complete adjustment in the terms of the original executory contract of sale of a capital asset. If it is conceded (Br. 6, 19) that the original contract gave rise to a capital loss to the taxpayers, then it is submitted that the correct approach, both from the point of view of the applicable law and that of common sense, is to consider the second part of the transaction, the renegotiation in August, in the same light as the original February transaction. Therefore, it too resulted in a capital loss to the taxpayers.

If the view of the Commissioner is sustained in this respect, that the August transaction was part and parcel of the whole transaction which commenced in February, then it cannot be disputed that there was a sale or exchange of a capital asset. There is no controversy about the fact that there was a sale or exchange of the taxpayers' interests in Boreva Sportswear, nor is there

dispute that these interests constituted capital assets. Viewing the transaction as a whole it is evident that there was here a sale or exchange of a capital asset. The fact that this sale or exchange was effected by several steps in a transaction, rather than at once, does not make it any the less a sale or exchange. The various cases cited by the taxpayer (Br. 10-13) for the point that a cancellation or compromise of indebtedness is not a sale or exchange of a capital asset are consequently inapposite to the factual situation at hand, since here there is not a simple compromise or cancellation of indebtedness but rather, as found by the Tax Court (R. 46), a complete renegotiation of the unexecuted portions of a contract for the sale of a capital asset.

The Commissioner therefore urges the Court that the sequence of events which started in February of 1947 and ended in August 1947 are all part of one transaction, as the Tax Court determined (R. 46-47), and that all losses sustained by the taxpayers as a result of this transaction are capital losses.[2]

II

Even if the Tax Court Erred in Holding that the Taxpayers Sustained Capital Losses, the August, 1947, Renegotiation of the Executory Contract of Sale Did Not Bring About a Loss "Incurred in Trade or Business" Within the Meaning of Section 23(e) of the 1939 Code

As has been pointed out above, the Commissioner concedes that the taxpayers are entitled to and he has allowed (R. 9, 19) the taxpayers a capital loss deduction for losses sustained in the renegotiation of their

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[2] The taxpayer to the contrary notwithstanding (Br. 10), the burden is on the taxpayer to show that the Commissioner's determination that this was a capital loss is erroneous.

executory contract for the sale of partnership interests. The taxpayers, however, contend that such a loss is not a capital loss. If the Commissioner is incorrect, and the loss is not a capital loss, then it is necessary for the taxpayers to show that they fall within some specific provision of the Revenue Code allowing a deduction for such loss as an ordinary loss. This the taxpayers have failed to do.

The cases cited by the taxpayers to the effect that a compromise or cancellation of indebtedness results in income to the debtor have no bearing on whether or not the same compromise or cancellation of indebtedness results in a deductible loss to the creditor, since what may be income *reportable* by a debtor is not necessarily a loss *deductible* by the creditor. It is well settled that deductions from gross income are matters of legislative grace. *White* v. *United States,* 305 U.S. 281. The taxpayers, moreover, contend that the loss sustained was a loss "incurred in trade or business" and is deductible under Section 23(e)(1) of the Code, *supra.* Adopting, however, for the purposes of argument, the taxpayers' view that the August transaction must be considered separate and apart from anything that occurred earlier, it is difficult to see how they attach the loss to a trade or business. The claim which the taxpayers held against their ex-partners was a claim completely unrelated to any business which the taxpayers happened to be in at the time that the loss was incurred. The mere fact that they happened to be in financial difficulties in a new and unrelated business which was established subsequent to the sale of their partnership interests does not serve to relate this particular claim to the new business which was formed after the claim arose. The fact that the taxpayers needed capital for their

new business does not make the loss in August a loss of that business. In order for a loss to be deductible under Section 23 (e) (1) of the Code as a loss incurred in a trade or business, it is obvious the loss must be the proximate result of the business enterprise. From the agreed facts it can be seen here that this loss did not arise out of the California enterprise but was a result of a series of transactions concerning the sale of interests in a separate and distinct partnership which operated in a different locality. Furthermore, the sale of these partnership interests did not constitute a trade or business of taxpayers. Finally, what the taxpayers desired to do with the proceeds of the sale is not material herein, and the mere fact that they used the proceeds as capital in their new and unsteady enterprise is of no consequence.

None of the cases cited by the taxpayers in support of their argument that the loss is deductible under Section 23(e)(1) present a factual situation akin to that presently before this Court. In *West Coast Securities Co.* v. *Commissioner,* 14 T.C. 947, the taxpayer was a corporation and the indebtedness which it compromised was a note which was acquired as an investment in the ordinary course of its business. Moreover, the deductibility of the loss was covered by the broad provisions of Section 23(f) of the Code. *Hutcheson* v. *Commissioner,* 17 T.C. 14, and *Gannon* v. *Commissioner,* 16 T.C. 1134, both present situations where retiring partners were not paid for their partnership interests, but forfeited certain interests upon retiring. As against the Commissioner's contention that such forfeitures resulted in capital losses, the Tax Court held that there was no sale or exchange of a capital asset as a result of the forfeiture, and accordingly held the losses to be ordi-

nary losses. The cases cited by the taxpayers all present instances of losses incurred in a trade or business, however, these cases are all far removed factually from the situation at hand. As we have indicated, the only trade or business in which the taxpayers were engaged in August, 1947, when they renegotiated their sales contract was in a newly established California enterprise. The fact that they incurred a loss in the sale of a capital asset because they needed money quickly to add to the capital of their new business does not make the loss incurred a loss of the new trade or business.

Since the loss in question was not a loss incurred in a trade or business, the taxpayers are not entitled to deduct any portion of the loss unless the Commissioner's position that this was a loss in the sale of a capital asset is upheld, and then only the portion provided by the statute.

CONCLUSION

For the reasons stated above, it is submitted that the decision of the Tax Court was correct and should be affirmed.

Respectfully submitted,

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